Senate Budget and Fiscal Review—Wesley Chesbro, Chair

SUBCOMMITTEE NO. 4 Agenda

Mike Machado, Chair
Tom McClintock
Christine Kehoe

Wednesday, May 17, 2006
9:30 a.m.
Room 113

Consultants: Dave O'Toole, Danny Alvarez

"A" AGENDA

Vote-Only Budget Items

ITEM	ISSUE	DESCRIPTION
Control Section 12.00	State Appropriations Limit	Control Section 12.00 establishes the amount of the State Appropriations Limit for the fiscal year of the budget. The LAO has proposed that trailer bill language be enacted to make a technical correction to Government Code Section 16418, which requires the Legislative Analyst and the Director of Finance to send a joint letter to the Controller telling him/her that there is enough room under the state's spending limit to transfer any year-end unencumbered funds into the special fund for economic uncertainties. The proposed technical correction eliminates a "double counting" problem with the calculation. The correction would not have any impact on the spending limit calculations themselves.
0110—Senate	State Appropriations Limit Adjustment	Adopt technical budget adjustment to decrease schedule (4) of this item by $39,000
0120—Assembly	State Appropriations Limit Adjustment	Adopt technical budget adjustment to decrease schedule (4) of this item by $53,000
1730—Franchise Tax Board	Federal Funds Adjustment for Reimbursements to the California Child Support Automation System (CCSAS) Project	The Administration requests that Franchise Tax Board federal funds reimbursement authority be increased by $43,000 to reflect an increase in federal funds available for the CCSAS project. This amount augments the increase in federal funds described in the next issue. The two augmentations were presented separately due to a timing difference in recognizing the availability of the funds.
1730—Franchise Tax Board	CCSAS: Business Partner Change Orders	The Administration requests that Franchise Tax Board federal funds reimbursement authority be decreased by $454,000 to reflect a reduction in the CCSAS Business Partner change order requests. This is a conforming action with a Department of Child Support Services Finance Letter.
1730—Franchise Tax Board	CCSAS: Data Capture Staffing	The Administration requests that Item 1730-001-0001 be revised by augmenting Franchise Tax Board (FTB) staff by 8.0 positions so that the FTB may perform data capture services for the Department of Child Support Services (DCSS). Position funding of $256,000 (reimbursements from DCSS) was approved by the Subcommittee on May 11, 2006.

1730—Franchise Tax Board	CCSAS: Child Support Transitional Arrears System Change	The Administration requests that Item 1730-001-0001 be increased by $1.02 million General Fund, and that federal funds reimbursement authority be increased $1.98 million, to facilitate system updates associated with tracking the date when child support payments are received from non-custodial parents. The following provisional language is related to this issue: *Provision X. Of the amount appropriated in this item, $3,000,000 shall be available for enhancements to the California Child Support Automation System project to enable the receipt and recording of child support transitional arrears payments. This funding shall not be expended until the Department of Finance approves the Advance Planning Document/Special Project Report and no sooner than 30 days after notification in writing of the necessity thereof, is provided to the Chairperson of the Joint Legislative Budget Committee and the chairperson of the committee in each house of the Legislature that considers appropriations, unless the Chairperson of the Joint Legislative Budget Committee, or his or her designee, imposes a lesser time.*
1760—Department of General Services	Capitol Security Equipment	The eight x-ray machines currently in use at the entrances to the Capitol building, LOB building and Capitol garage have realized their life expectancy due to age and heavy usage. The seven metal detectors throughout Capitol entrances face similar problems. The Department of General Services budget requires an augmentation of $472,693 to replace this equipment. Out of this amount, $427,670 will replace the x-ray machines and $45,023 will replace the metal detectors.

1760—Department of General Services	Fuel and Preventative Maintenance	The Department of General Services requests that Item 1760-001-0666 be increased by $1,461,000 to allow the Department of General Services to recover fuel costs and preventative maintenance services for 530 vehicles purchased in the current year for lease to the Department of Corrections and Rehabilitation, Adult Parole Operations.
1760—Department of General Services	Increased Security at the Elihu Harris Building	The Department of General Services requests that Item 1760-001-0666 be increased by $1,006,000 for increased security for the Elihu Harris Building in Oakland, California. This adjustment is requested pursuant to the CHP's site security assessment of the building. The Department of General Services also requests that Item 1760-002-0666 be decreased by $800,000 to reflect lower debt service costs for this building, and that Provision 1 of this item, and Item 1760-001-0666 be amended to reflect this change.
1955—Department of Technology Services (DTS)	Teale Data Center, Health and Human Services Data Center, and Telecommunications Division of the Department of General Services Consolidation Savings	The Administration requests that the DTS budget be reduced by $1,091,000 and 8.7 positions to reflect staff savings achieved as a result of Data Center Consolidation. The DTS now serves the common technology needs of state departments, improves and coordinates the use of technology, eliminates duplications, and brings about economies that could not otherwise be obtained. This reduction conforms to the first year of a four-year plan to achieve $45.6 million in consolidation savings.
9100—Tax Relief	Funding Adjustment for Senior Citizens' Property Tax Assistance and Senior Citizens' Renters' Tax Assistance Programs	The Administration requests that Item 9100-101-0001 be increased by $5,563,000 to reflect a decrease of $420,000 in the Senior Citizens' Property Tax Assistance Program and an increase of $5,983,000 in the Senior Citizens' Renters' Assistance Program. These changes are based on revised participation calculations from the Franchise Tax Board.
9100—Tax Relief	Increased Funding for the Senior Citizens' Property Tax Deferral Program	The Administration requests that Item 9100-101-0001 be increased by $2,100,000 to reflect the receipt of revised participation calculations for the Senior Citizens' Property Tax Deferral Program from the State Controller's Office.

VOTE ON VOTE-ONLY ITEMS:

DISCUSSION ITEMS

Control Section 3.45

The Governor's Budget includes a Control Section 3.45, intended to generate $58 million in savings through a cut to departmental budgets. Agency secretaries will be provided target reduction goals of one percent of salaries and wages costs, which will be achieved primarily through eliminating vacancies, but also through nonsalary reductions to staff benefits and operating expenses.

Staff Comment: There is no particular justfication for this type of unallocated reduction, as opposed to the unallocated reduction included in control section 4.05 (described below). The Governor's Budget includes growth of more than 2000 positions, with the April Finance Letters and May Revision Finance Letters adding hundreds more. If containment of position growth is sought by the Administration, a more deliberative approach is through negative budget change proposals.

In their *Analysis of the 2006-07 Budget Bill,* the LAO critiqued these types of unallocated reductions, noting that past authorities for reductions have not achieved their intended objectives, some savings were scored but not achieved, program impacts are usually unknown, and the reductions reflect Administration's priorities, not the Legislature's.

Staff Recommendation: REJECT Control Section 3.45

VOTE:

Control Section 4.05

Control Section 4.05 is intended to generate $200 million in budget year savings through unspecified reductions in departments' budgets. These reductions can be separated into two components:

- In the budget year, $100 million will be achieved through departmental savings to be identified. Savings may be achieved through General Fund reversions, the most effective method of realizing savings in recent years.
- An additional $100 million, authorized by intent language included in Control Section 4.05 of the 2005 Budget Act. That budget bill language asserted that the intended use of those savings would be to increase the General Fund reserve by $200 million by the end of 2006-07.

Staff Comment: The Administration's success in achieving unallocated savings objectives has been mixed. For example, an additional $150 million in *department-specific* unallocated reductions originally included in the proposed 2005-06 budget were, through budget hearings and revised estimates, reduced to an *estimated* $75 million in ongoing savings.

The Legislature had sought specific information on how these department-specific reductions would occur and added Control Section 4.10 to the 2005 budget bill, which stated:

> *SEC. 4.10. No later than December 10, 2005, the Director of Finance shall report to the Chairperson of the Joint Legislative Budget Committee and the chairpersons of the fiscal committees of each house the reductions made pursuant to the unallocated reductions included in this act. The report shall include the following: each specific reduction by department, agency, and program; whether the reduction is one-time or ongoing; its programmatic effects; the number and description of positions affected; and any other description necessary to fully disclose the reduction's impact.*

Proposed section 4.10 of the 2005-06 budget bill was vetoed with the message,

> *"This language is an infringement on the Executive Branch's budget development process as the information necessary to produce this report may include budgetary decisions that would not be reached until the preparation of the 2006-07 Governor's Budget was complete."*

If Control Section 4.05 is to be implemented, reporting to the Legislature should be enhanced so programmatic impacts can be fully disclosed. The following amendment to the budget bill would improve oversight in a manner that won't infringe upon executive privilege during the budget development process.

> (e) The Director of Finance shall report to the Chairperson of the Joint Legislative Budget Committee and the chairperson of the committees of each house of the Legislature that consider appropriations not ~~more than 30 days after the reductions are made pursuant to this section~~ *later than February 15, 2007, the amount of the reductions made in each item of appropriation pursuant to this section*. The report shall ~~list the specific reductions, by department, agency, and program, and state the programmatic effects and impacts of each reduction~~ *include the following: each specific reduction by department, agency, and*

program; whether the reduction is one-time or ongoing; a description of programmatic effects; the number and description of positions affected; and any other description necessary to fully disclose the reduction's impact.

Furthermore, prudent limits on reductions should be enacted in order to limit the effect on state operations or local assistance appropriations. The following language, adopted in the Budget Act of 2004, would again provide the necessary protection.

A state operations appropriation, and a program, project, or function designated in any line of any schedule set forth by that appropriation, may not be reduced pursuant to subdivision (a) or Control Section 4.05 of the 2005 Budget Act by more than 20 percent. A local assistance appropriation, and a program, project, or function designated in any line of any schedule set forth by that appropriation, may not be reduced pursuant to subdivision (a) or Control Section 4.05 of the 2005 Budget Act by more than 5 percent.

Staff Recommendation: AMEND Control Section 4.05 to include the reporting language and reduction limits identified above.

VOTE:

Control Section 35.60: Budget Stabilization Account Transfer to the General Fund

Budget control section 35.60 provides statutory authority for the Director of Finance to transfer funds from the Budget Stabilization Account to the General Fund. This control section allows the Director to determine when a shortfall has occurred and then order a transfer to the General Fund in an amount sufficient to ensure there is a prudent General Fund reserve. The Director of Finance must notify the Joint Legislative Budget Committee and the Appropriations committees of each house within 15 days of making the transfer.

The department reports that this control section is necessary to satisfy the constitutional requirement enacted in Proposition 58 that transfers from the Budget Stabilization Account to the General Fund must have statutory authority. Additionally, this section would enhance the Director of Finance's capacity to respond to situations where continuous appropriations have reduced the General Fund reserve and augmentation is necessary.

Staff Comment: Proposition 58 is silent on how statutory authority must allow transfers from the Budget Stabilization Account to the General Fund. The proposed budget authority is unnecessary, as a stand-alone bill would provide the same authority with full legislative review.

Staff Recommendation: DELETE Control Section 35.60.

VOTE:

0860 Board of Equalization

The State Board of Equalization (BOE), the Franchise Tax Board (FTB), and the Employment Development Department (EDD) are the state's major tax collection agencies. The BOE collects state and local sales and use taxes and a variety of business and excise taxes and fees, including those levied on gasoline and diesel fuel, alcoholic beverages and cigarettes, as well as others. BOE also assesses utility property for local property tax purposes, oversees the administration of local property tax by county assessors, and serves as the appellate body to hear specified tax appeals, including FTB decisions under the personal income tax and bank and corporation tax laws.

The Governor's budget funds 3,802.9 positions (including 64.5 new positions) and proposes $370.6 million in total expenditures ($212.8 million General Fund).

1. Electronic Waste Recycling Fee Program Funding

The Board of Equalization's budget includes a direct appropriation of $5.2 million in the current year and $5.0 million in the budget year from the Integrated Waste Board's (IWMB) Electronic Waste Recovery and Recycling Account. These funds are used to administer the collection of electronic waste ("e-waste") fees from applicable retailers.

Staff Comment: In the first year of this program, 2004-05, the BOE was funded on a reimbursement basis. However, based on problems with receiving reimbursement from the IWMB, the payment method was shifted to a direct appropriation. For example, it took three to six months to get an interagency contract for E-Waste Recycling Fee collection approved. Notwithstanding these past problems, the IWMB recently assured Senate Budget Subcommittee #2 that they will pay BOE for services promptly if the reimbursement basis is restored.

A reimbursement basis is better practice in general, in that it will allow the lead agency responsible for the statutorily-directed activity (recycling of electronic waste), to be held fully accountable for administrative expenditures related to this program, including BOE's cost of collection.

Staff Recommendation: REDUCE the BOE appropriation from the Electronic Waste Recovery and Recycling Account by $5.2 million and INCREASE reimbursements from the IWMB by the same amount.

VOTE:

2. BCP: Retail Licensing Enforcement
The Board of Equalization requests 14.5 two-year limited term positions and $1.6 million ($1.1 million General Fund) in 2006-07 and $1.5 million ($950,000 General Fund) in 2007-08 for a pilot project to identify and register businesses that sell tangible personal property without a seller's permit. These resources will enable the BOE to identify and register entities who are actively engaged in business in California and selling tangible personal property without a seller's permit. This proposal will attempt to validate the voluntary change in registered businesses and increased revenue (i.e. indirect compliance) resulting from the licensing sweeps program.

The BOE estimates that revenues will be $12.6 million General Fund for both years of the pilot, a 7-to-1 benefit-cost ratio in the first year and 8.6-to-one benefit-cost ratio in the second.

The proposal is for a two-year pilot in one metropolitan area still to be determined. With only 16 approved positions, the Investigations Division must confine the pilot to one district. The BOE reports that the start-up delay will be limited as this activity requires little training and is expected to be a sought-after assignment for experienced auditors.

For businesses who comply with the law, under this proposal, there should be no interaction with the BOE investigator. Retail licenses are required to be posted publicly. If they are not, the visit should last as long as it takes the storeowner to show the license.

Staff Comments:
(*This issue was previously heard at the March 9 Subcommittee hearing.)*

Revenues are probably higher than estimated. The BOE assumes the minimum in taxable sales ($120,000) from all businesses they will encounter. However, the average business revenue in two possible pilot locations, Los Angeles and the Bay Area, is at least $400,000.

Furthermore, the BOE does not account for audit leads that will be generated by the findings of front line auditors. For example, if a licensee's sales tax returns indicate that 80 percent of their sales are sales of exempt food products but upon inspection our staff notes that over 80 percent of the inventory is products that would be subject to tax, an audit lead will be created. That lead will be forwarded to the district office to conduct an audit because of the high likelihood of an understatement of sales taxes.

Finally, the revenue estimate of $12.6 million is based on a three percent noncompliance rate found among retailers during the three initial pilot projects. However, four subsequent pilot projects discovered a *higher* noncompliance rate of between five and seven percent. This higher rate would likely affect the overall revenue estimate, as well as the staffing need.

Seven pilots suggest statewide rollout needed. The BOE has conducted a total of seven pilot studies on retail license noncompliance. The pilots have involved everything from targeted business sweeps to investigations involving over 2300 businesses in seven communities. The communities of central Fresno, south Stockton, Sacramento, downtown Oakland, northern San Jose, downtown Santa Clara, and central Gilroy have all participated in the pilot projects. The seven pilots suggest there are somewhere between 30,000 and 70,000 unlicensed retailers operating in California.

A larger rollout of retail license sweep activity would be consistent with the most recent retailer enforcement measure undertaken by the BOE: inspections of cigarette and tobacco products licenses. Currently, the BOE's Investigations Division has 40 inspectors who conduct approximately 10,000 inspections per year. Under the Cigarette and Tobacco Licensing Act, inspections have increased voluntary compliance and revenues by over $115 million since inception. Establishment of a statewide cigarette and tobacco licensing program is a precedent for rolling out a statewide retail licensing enforcement program.

Based on the information provided, approval of the proposed BCP would delay a practical and proven response to bridge the tax gap and enable scofflaws to further flout state law for their own unfair economic advantage. Funding a statewide proposal could help level the economic playing field in *every* region, not just one. Furthermore, statewide implementation in a variety of areas will enable better data gathering on the actual indirect compliance effect and allow the Administration and Legislature to make better decisions with regards to future resource allocations for this program.
In response to staff inquiries regarding the costs of a statewide rollout, the BOE has explained that 59 positions would be needed to fully staff all offices statewide over a three or four-year period. Revenues are conservatively estimated at $50.4 million, but could rise as high as $69.6 million.

The BOE has raised a number of concerns regarding staff's earlier suggestion that the retail licensing enforcement be considered for a statewide rollout. Specifically,

Verifiable overhead and administrative costs have not been calculated.

> Response: Staff has requested and been informed that the BOE cannot determine overhead costs at this time. The BOE will consider using the budget process next year if additional staffing and support need is identified.

Assumptions above three percent noncompliance are risky.

> Response: Staff concurs with the conservative approach and recommends a reevaluation program performance early next year to see if a higher rate of noncompliance is discovered statewide.

Recruitment at this level could be difficult in a two year pilot. A three or four-year pilot would be more practical and functional.

> Response: Staff concurs with a three-year pilot. Performance should be actively monitored during that time and resources adjusted as necessary.

A statewide rollout will precipitate a large and sudden shift of experienced personnel to these audits. These senior auditor positions have limited peace officer status, making them a tempting promotion to experienced personnel. To the extent that personnel shift from one area to retail licensing enforcement, experience will suffer in the other areas.

Response: The enticement of promotion and limited peace officer status is not a unique or new challenge for the department. The Board of Equalization has embarked on several new strategies to address this problem, as was described in an April 2006 report entitled, “Recruitment and Retention: Strategic Vision and Initiatives.”

STAFF RECOMMENDATION: AUGMENT the Retail Licensing Enforcement budget change proposal $5.1 million and 44.5 positions for three years limited term. This staffing augmentation will generate $59.6 million in revenues that the state should already be collecting.

VOTE:

3. Sales and Use Tax Administration Cost Allocation for Triple Flip

During the March 9, 2006, hearing, the Subcommittee considered and approved an updated methodology for allocating costs for administering and enforcing sales and use tax between the Special Taxing Jurisdictions and the state. BOE estimates that use of the new methodology would reduce General Fund costs by $5.7 million in 2006-07.

In a related tax administration issue, it has come to light that the state has been shifting an excessive amount of property tax revenue from schools to local governments under the "Triple Flip," resulting in an excess General Fund cost of approximately $10 million annually.

Under the "Triple Flip," the state imposed a new temporary quarter-cent Sales and Use Tax (SUT) dedicated to repayment of the Economic Recovery Bonds (ERBs). The state also suspended a quarter-cent of the local Bradley-Burns tax in order to keep the total rate constant. In the second leg of the Triple Flip, local governments are kept whole by transfers of property tax revenue to cities and counties from schools. In the third leg, the state General Fund makes schools whole by replacing the amount shifted property tax revenue. The net result is that the General Fund bears the cost of repayment of the ERBs in the form of higher payments to schools.

State law (Revenue and Taxation Code Section 97.68) requires the Director of Finance to provide the county auditors with annual estimates of the local Bradley-Burns revenue loss. The county auditors then shift an equal amount of property tax revenue from the schools to the cities and counties. The auditor’s estimate must be based on the "actual amount of sales and use tax revenues transmitted" to cities and counties in the prior year under the Bradley-Burns tax (adjusted to a one-quarter cent basis) plus an estimated growth factor. There is also a settle-up adjustment each year to reconcile the prior-year estimate with the actual revenue loss. The intent of this process is to replace the local Bradley-Burns revenue loss with a precisely equal amount of property tax revenue.

However, the Bradley-Burns revenue loss estimates forwarded by BOE to the Department of Finance (DOF) have been based on Bradley-Burns revenue collections, rather than revenue transmittals. The difference is that the amounts local governments actually receive are less a deduction for administrative costs. The Department of Finance has forwarded these amounts to county auditors without correcting them. As a result, cities and counties have received more property tax revenue under the Triple Flip than their actual loss of sales and use tax revenue. The difference is about $10 million annually.

Staff Comment: Under existing law, the half-cent SUTs imposed for Realignment (the Local Revenue Fund) and for local public safety (the Local Public Safety Fund) are not assessed for administrative costs. Instead, those costs are born primarily by the state General Fund. Adoption of the new cost-allocation methodology would not change this.

The issue here is not whether local governments should be "charged" for collecting the quarter-cent tax–the state is actually paying this portion of BOE's administrative costs while the Triple Flip is in place. The question is whether the law requires replacement of the suspended local revenues that cities and counties actually would have received (the net revenue) or whether local governments receive a "bonus" from the state. At staff's request, Legislative Counsel has reviewed the relevant statutes and opined that they require the replacement of the net revenue loss.

DOF should take corrective action to realize General Fund savings of $20 million for the 2006-07 Budget. This would be accomplished by correcting the 2005-06 allocation in the 2006-07 settle-up and using the correct methodology for the 2006-07 estimate. There also would be ongoing annual General Fund savings in excess of $10 million until the ERBs are paid off and the Triple Flip ended.

Staff Recommendation: REQUEST DOF and BOE respond to this issue and confirm their intent to carry out the Triple Flip calculations required by law.

VOTE:

4. Resale Certificate Abuse

The 2005-06 Budget included Supplemental Report Language directing the BOE to report on the results of its pilot audit of compliance problems in the use of resale certificates. Resale certificates are forms given to retailers by purchasers who claim exemption from paying sales tax on the basis that they are a registered seller and the purchase is for resale.

The BOE has obtained a statewide database of tax-exempt sales for resale from a major Big Box retailer. Initial indications are that purchasers provided a significant number of invalid sellers permit numbers and that a significant amount of purchases using valid numbers appear to be for items that are not in the purchaser's line of business (a jewelry purchase using a gas station resale permit, for example).

Staff Comment: The Board has not been able to fully analyze and follow-up on the information provided by the Big Box retailer at this time. However, BOE intends to do so in the next few months. Accordingly, staff suggests adoption of the following Supplemental Report Language:

The State Board of Equalization shall report to the Legislature by January 1, 2007 on the results of its pilot audit of the use of resale certificates at a "Big Box" retailer. The report shall identify significant types of compliance problems, estimate revenue losses due to noncompliance and tax evasion, and make recommendations to improve compliance, including, if warranted, modifications to the resale certificate process such as the use of data-encoded permit cards.

Staff Recommendation: ADOPT Supplemental Report Language (identified above).

VOTE:

8885 Commission on State Mandates

The Commission on State Mandates is a quasi-judicial body that makes the initial determination of state mandated costs. The Commission is tasked to fairly and impartially determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state. The Governor's budget funds 14 positions (with no new positions) and expenditures of $243.4 million.

1. Mandate Funding Modifications in May Revision

The Administration proposes several changes to funding for mandate funding. These changes affect funding in past years, current year, budget year, and 2007-08. The key components are described below.

- The Administration proposes to revise their Governor's Budget proposal of funding both past year (2005-06) and current year (2006-07) mandates. The May Revision Finance Letter proposes an increase of $90.28 million for 2005-06 mandate claim expenditures, while deleting $46.20 million for 2006-07 costs (a net increase of $44.07 million). This approach reflects an interpretation of Proposition 1A that the state has no obligation to fund budget year mandates, but must fund the current year mandates ("full payable amount for mandates that have not been previously paid" (Article 13B, Section 6 of the California Constitution).

- The Administration requests to reduce funding by $40 million for mandates recently approved by the Commission on State Mandates. Under Proposition 1A, the state must budget funding for the prior-year cost of newly determined mandates.

- The Administration requests that Item 8885-299-0001 be increased by $71.8 million to fund the first and second year of the statutory repayment of non-education mandates over a 15-year period. Proposition 1A authorizes the state to pay mandate claims due prior to 2004-05. Later statute set the repayment over a period of 15 years, beginning in 2006-07. The size of the backlog is approximately $1.2 billion. Using more recent mandate claims cost information from the State Controller, the Administration proposes to: (a) reduce the 2006-07 mandate repayment amount by $15.1 million (to $83 million), and (b) pre-pay the 2007-08 mandate repayment amount of $86.9 million.

Staff Comment: The Administration's proposals reflect a substantial new commitment to paying down mandate debt. Of the proposals, the following two requests are consistent with Prop 1A and should be funded:

- ***Current Year (2005-06) Mandate Costs: $90.3 million***
- ***First Year of the 15-Year Payback of Costs Due Prior to 2005-06: $83.0 million***

However, the May Revision proposal does not reflect the most consistent and, in some cases, the most cost-effective approach to paying off mandate costs. The following adjustments are appropriate:

Prior-Year Cost of Newly Identified Mandates: -$5.7 million.
Funding for these costs is inconsistent with the Administration's position of, pursuant to Prop 1A, not funding budget year mandate costs. These costs should be excluded.

2007-08 Mandate Payback: -$86.9 million
Advance funding for the 2007-08 share of past due mandate costs, while useful as a debt reduction tool, does not merit advance payment relative to the other unrecognized costs described below.

Past Year and Half Year of AB 3632 Mandate Costs: +$117.5 million
The Administration proposes to shift the AB 3632 program to a categorical program. If enacted, this shift would be effective sometime in the budget year. To be prudent, the estimated full implementation date would be January 1, 2007. Consequently, the state should fund the first half-year cost of the AB 3632 mandate (approximately $51.5 million).
Consistent with the Governor's proposal to fund prior year mandate costs, the Governor should include funding for prior year mandate claims for this mandate (approximately $66 million).

2005-06 Costs for Peace Officer's Bill of Rights (POBOR) Mandate: +$16.6 million
The May Revision does not include funding for the POBOR Mandate, a long deferred mandate. To begin to appropriately recognize the cost of this mandate at the time when costs are incurred, this mandate should be funded.

Audit Exception Recognition: -$44 million
The State Controller's Office (SCO) has temporarily suspended fully enforcing audit exceptions for disallowed or reduced mandate claims. This suspension has permitted overpayments to mandate claimants, which must be recovered. The Department of Finance has amended this situation by requiring the SCO to collect these costs in the budget year. Recoupment of these overpayments in the budget year will result in a substantial savings to the state.

(Overall Adjustment to May Revision Proposal: -$3 million)

Staff Recommendation: APPROVE the overall mandate funding reduction of $3 million, consistent with the staff comments above.

VOTE:

2. April Finance Letter: Conversion of Limited-Term Test Claim Backlog Positions to Permanent
The Administration requests to convert three positions established in the 2004 Budget Act from three-years limited term to permanent positions. This request would have no fiscal effect until 2008-09, when an ongoing commitment of $322,000 would be recognized. The three positions, two Staff Counsel IIIs and one Staff Services Manager I, were established last year for the purpose of eliminating a backlog in mandates proposed for reconsideration.

Additionally, the Administration proposes to add the following budget bill language requiring reporting on workload levels and mandate backlog. This reporting language will allow the Department of Finance to track workload and propose elimination of the positions if they are no longer needed.

> *2. The Commission on State Mandates shall, on or before September 15, 2006, and annually thereafter, submit to the Director of Finance a report identifying the workload levels and any backlogs for the Commission on State Mandates' staff.*

Staff Comment: A significant fiscal savings incentive exists for the Legislature to adopt this Finance Letter in that having staff to help reconsider mandates and process disputes often results in reductions to truly eligible reimbursement costs.

Staff Recommendation: ADOPT the Finance Letter.

VOTE:

9620 Payment of Interest on General Fund Loans

The Administration requests that Item 9620-002-0001 be increased by $21.0 million to provide funding for the repayment of interest on 12 General Fund budgetary loans. As a result of prepaying in 2006-07 $176.9 million in special fund loans to the General Fund that had been expected to be repaid in 2007-08, it is estimated that $21.0 million in additional interest cost will be incurred in 2006-07 that would otherwise be payable in 2007-08.

The following loans and interest amounts would be repaid, as shown below.

Department	Description	Amount ($s in 000s)	"Scheduled" Repayment Date	Interest Payment ($s in 000s)
Department of Consumer Affairs	Loan from Osteopathic Medical Fund	$2600	06/01/2007	$274
Department of Consumer Affairs	Loan from Pharmacy Fund	3000	06/01/2007	355
Department of Consumer Affairs	Borrow from State Dentistry Fund	2500	06/01/2007	296
Department of Consumer Affairs	Borrow from Registered Nursing Fund	6200	06/01/2007	733
Department of Consumer Affairs	Borrow from Barbering and Cosmetology Fund	900	06/01/2007	106
Department of Consumer Affairs	Loan from Structural Pest Fund	2000	06/01/2007	237
California Energy Commission	Loan from Renewable Resources Trust Fund to GF	150,000	06/01/2007	710
Department of Corrections	Loan from State Corporations Fund	6000	06/01/2007	17740
Department of Housing and Community Development	Loan from Manufactured Home Recovery Fund	400	06/01/2007	25
Department of Housing and Community Development	Loan from Housing Rehabilitation Loan Fund	500	06/01/2007	32
Department of Consumer Affairs	Loan from Court Reporters Fund	1,250	06/01/2007	61
Department of Consumer Affairs	Loan from Acupuncture Fund	$1,500	06/01/2007	$73

Staff Comment: While the majority of loans due for repayment in 2007-08 are proposed for prepayment next year, loans coming due in 2008-09 are not recommended for early repayment. Given the several billion dollar budget shortfall anticipated in 2008-09, it appears prudent to devote additional resources to special fund loan repayments now, before additional interest costs accrue. According to the Department of Finance, the total amount of special funds due in 2008-09 is $463.5 million.

Staff Recommendations:
1. APPROVE the Finance Letter.

2. Request the Department of Finance respond to staff's comments about devoting additional resources to 2008-09 special fund loan debt.

VOTE: